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SUBJECT: CENTRAL BANK MAINTAINS INTEREST RATES DESPITE RISING  
INFLATION

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SUMMARY  
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**¶1.** (U) Overall inflation in the Egyptian economy reached 12% year-on-year (y-o-y) in December 2006, with the greatest increase in food and energy prices. The Monetary Policy Committee (MPC) of the Central Bank of Egypt (CBE) met February 1 and decided to maintain interest rates at their current level, despite rising inflation. GOE officials continue to attribute inflationary pressure to external shocks such as last year's outbreak of Avian Flu and high international energy prices. All political parties in Egypt's parliament, and even President Mubarak, have called for GOE action to curb inflation and protect low-income earners. CBE has taken some steps to absorb liquidity in the market, but so far, the banking sector has not responded as hoped. The Ministry of Finance also recently reduced tariffs to curb food and product input prices.

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INFLATION STILL RISING  
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**¶2.** (U) Inflation continued to climb in December 2006, as overall inflation reached 12% y-o-y, a 0.2% increase over November 2006. Although costs for some goods and services declined in December, food and energy, the average Egyptian's main consumer goods, remained high.

Following is a breakdown of basic commodity price increases:

- Bread/cereals - increased 4.3% between 10-11/2006;
- Vegetables - increased 2.9% between 11-12/2006 and 38.2% y-on-y to 12/2006;
- Meat - increased 24.1% y-o-y to 12/2006;
- Dairy products - increased 16.1% y-o-y to 12/2006;
- Fish/seafood - increased 1.4% between 11-12/2006 and 11.3% y-o-y to 12/2006;
- Energy prices - increased 13.1% between 11-12/2006 and 11.5% y-o-y to 11/2006.
- Poultry prices fell sharply in preliminary January 2007 figures. Prices of white and frozen poultry dropped 2.5% and 2.1%, respectively, between November 1, 2006 and January 15. Analysts attribute the decline in poultry prices to new outbreaks of Avian Flu discouraging poultry consumption. A similar phenomenon occurred

in January/February 2006, after the first outbreaks of Avian Flu in Egypt.

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MONETARY POLICY COMMITTEE MEETS  
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¶3. (U) The MPC met on February 1 and decided to maintain overnight lending and deposit rates at 8.75% and 10.75%, respectively, defying expectations of a rate hike to counter inflationary pressure. In a press statement, CBE Deputy Governor Tarek Amer noted that the MPC decided not to raise interest rates because of signs that inflation may slow in the coming months. The Central Bank continues to attribute high inflation to the pass-through effect from the Avian Flu outbreak and July 2006 cuts in fuel subsidies. CBE's view is supported by the Minister of Finance, who told a recent meeting of the U.S.-Egypt Business Council that he expects inflation to subside in the next few months, as world energy prices decline and the effects of Avian Flu and subsidy cuts phase out. Appearing before the People's Assembly in late January, Prime Minister Nazif repeated his mantra that inflation was less important than maintaining high economic growth rates.

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STRONG CRITICISM FROM OPPOSITION  
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¶4. (U) Egyptian media, along with parliamentarians from all parties, including the NDP, have strongly criticized the GOE for not taking greater action to curb inflation. After Nazif's appearance before parliament, the Economic Committee of the People's Assembly issued a statement claiming that while economic growth was important, the GOE had failed to meet its commitment to prevent price manipulation and speculative practices. In a February 5 meeting with economic ministers, President Mubarak called on them to implement monetary and fiscal policies to curb inflation and protect low income earners.

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STEPS TO CURB PRICES  
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¶5. (U) Although the MPC decided to maintain current interest rates, the CBE has taken steps recently to absorb excess liquidity in the market. In January, CBE began holding deposit auctions with rates as high as 10.5%. Bank response to the auctions was weak, however, as the deposits could not be resold and were subject to taxes. CBE has not announced any other plans to absorb excess liquidity in the short term. The average bank deposit rate for December 2006 was 6.9%, resulting in a negative real interest rate.

¶6. (U) In another attempt to lower prices, the GOE reduced tariff rates this week by 25%, resulting in an average tariff of 6.9%, down from 9%. Tariffs on agricultural produce, refrigerators, heaters, televisions and ready-to-wear clothes are now less than 10%; cars will continue to face a 40% tariff to protect Egyptian auto manufacturers. Minister of Finance YBG told the press the cuts are intended to not only counter inflation but to boost the competitiveness of Egyptian industries, which will be forced to compete with less-expensive imports while enjoying lower production costs.

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COMMENT  
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¶7. (U) Unless inflation subsides in the coming months, the GOE will find it increasingly difficult to maintain that external factors are pushing up prices. The challenge will be to convince the public that the economy's healthy growth rates are benefiting, or will benefit, the average Egyptian. This may be difficult unless economic growth begins producing more jobs for low and semi-skilled workers. Growth remains concentrated in export sectors, where expanded production has merely maintained current jobs, rather than creating new employment opportunities.